Office of Chief Counsel
Internal Revenue Service

memorandum

CC:WR:RMD:DEN:TL-N-336-00
JRRobb

date:

to: Chief, Examination Division, Rocky Mountain District
Attn: Tom Ellison, Examiner

from: District Counsel
Rocky Mountain District

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subject: [redacted] Indian Tribe Allottees
[redacted] and [redacted])

This is in response to your request for an advisory opinion regarding the above-referenced taxpayers and the issue set forth below.

ISSUE

Whether the income received by [redacted] and [redacted] ([redacted] Indian Tribe Allottees of the [redacted] Indian Reservation) from [redacted] pursuant to an oil and gas mining lease allowing [redacted] to drill for, mine, extract, remove, and dispose of oil and natural gas deposits from their allotted land is exempt from federal taxation.

CONCLUSION

We are of the opinion that the income that [redacted] and [redacted] receive from [redacted] pursuant to the oil and gas mining lease is exempt from federal taxation.

FACTS

On [redacted], [redacted] and [redacted] ("taxpayers") entered into an oil and gas mining lease with [redacted]. The taxpayers, in consideration of a cash bonus of $[redacted], granted to [redacted] the exclusive right and privilege to drill for, mine, extract, remove, and dispose of all the oil and natural gas deposits including helium gas, carbon dioxide gas, and sulphur gas in or

under [redacted] acres of their allotted Indian land. The taxpayers also receive a rental payment of $[redacted] per acre per annum and a royalty of [redacted] percent of the volume or amount of all oil, gas, and/or natural gasoline, and/or all other hydrocarbon substances produced or saved from the land. The royalty rate was adjusted to [redacted] percent following the end of the primary term of the lease (five years after entering into the lease).

DISCUSSION

The [redacted] Indian Tribe ("Tribe") is organized under the Indian Reorganization Act ("IRA"), 25 U.S.C. § 461-479. Under the IRA, it has adopted a written constitution establishing the structure of its government and the manner in which its affairs are conducted. The Tribe is governed by a tribal counsel.

The [redacted] Indian Reservation ("Reservation") is located in [redacted]. The geographic boundaries of the Reservation were confirmed by act of Congress in 1984. See Act of May 21, 1984, P.L. 98-290, 98 Stat. 201. The lands within the Reservation boundaries are a checkerboard of ownership interests, a characteristic common to many reservations. They include lands held in trust by the United States for the benefit of the Tribe, lands held by the Tribe in its own name, individual Indian allotments subject to federal trust restrictions, land owned in fee simple by individual Indians, and lands held in fee simple by non-Indian third parties.

As a general rule, Indians, like other citizens, are subject to federal income taxation unless exempted by a treaty or an act of Congress. Hoptowit v. Commissioner, 709 F.2d 564, 565 (9th Cir. 1983). Although ambiguous statutes and treaties are to be construed to grant tax exemptions in favor of Indians, they are not to be construed to grant tax exemptions unless they contain language which can reasonably be so construed. United States v. Anderson, 625 F.2d 910, 913 (9th Cir. 1980), cert. denied, 450 U.S. 920 (1981). The intent to exempt from taxation must be clearly expressed. Squire v. Capoeman, 351 U.S. 1, 6 (1956).

In Capoeman, the Supreme Court considered whether income received by an Indian from the government's sale of timber on his allotted land was subject to capital gains tax. The court found an income tax exemption based on the General Allotment Act of

1887, 25 U.S.C. § 331, et seq.[1] Finding a congressional intent to exempt allotted lands from all taxes until the fee interest was conveyed to the allottee, the court held that income received by noncompetent Indians from the sale of standing timber on allotted land was exempt from federal income tax but that "reinvestment income" was not. A "noncompetent Indian" refers to one who holds allotted land under a trust patent and who may not alienate or encumber that land without the consent of the United States. Kirschling v. United States, 746 F.2d 512, 513 n.1 (9th Cir. 1984). The court defined the scope of the exemption as "income derived directly from the land."

The stated rational for the "derived directly from the land" was the diminution of the land value. The court stated:

> Respondent's timber constitutes the major value of his allotted land. . . . Once logged off, the land is of little value. The land no longer serves the purpose for which is was by treaty set aside to his ancestors, and for which it was allotted to him. It can no longer be adequate to his needs and serve the purpose of bringing him finally to a state of competency and independence. Unless the proceeds of the timber sale are preserved for respondent, he cannot go forward when declared competent with the necessary chance of economic survival in competition with others. This chance is guaranteed by the tax exemption afforded by the General Allotment Act, and the solemn undertaking in the patent.

350 U.S. at 10.

Exemptions for income "derived directly from the land" have been upheld where the allottee has exploited or reduced the value of land by mining, logging, agriculture of similar activities. See Stevens v. Commissioner, 452 F.2d 741 (9th Cir. 1971) (income

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[1] The General Allotment Act gave the executive branch the authority to survey and allot parcels of land to individual Indians. Its primary purpose was the speedy assimilation of the Indians. Blackfeet Tribe of Indians v. Montana, 729 F.2d 1192, 1195 (9th Cir. 1984). Allotted land was to be held in trust by the United States, for the "sole use and benefit" of the Indian allottees, for a period of at least 25 years. At the end of the trust period, the land was to be conveyed to the allottee "in fee, discharged of said trust and free of all charge or incumbrance whatsoever." The Indian Reorganization Act of 1934, 25 U.S.C. § 462, extended the periods of trust "until otherwise directed by Congress."

from farming and ranching on allotted lands); United States v. Daney, 370 F.2d 791 (10th Cir. 1966) (income from oil and gas lease bonuses attributable to allotted lands); Big Eagle v. United States, 300 F.2d 765 (Ct. Cl. 1962) (royalty income from extraction of minerals from allotted land). However, where the Indians' statutory rights to take certain property interests free of encumbrances is not implicated, Capoeman does not apply and the income is taxable. Anderson, 625 F.2d at 914 (9th Cir. 1980), cert. denied, 450 U.S. 920 (1981).

The courts have applied the Capoeman standard to tax income from "non-land-based" businesses conducted on trust land. In Saunooke v. United States, 806 F.2d 1053 (Fed Cir. 1986), the court held that members of the Eastern Band of Cherokee Indians were not entitled to an exemption from income taxes for the portion of their income from tourism business and buildings, operating on the tax-exempt reservation lands. Similarly, in Critzer v. United States, 597 F.2d 708 (Ct. Cl. 1979), cert. denied, 444 U.S. 920 (1979), the court held that income from the operation of a motel, restaurant and gift shop on tax-exempt tribal land was not exempt from taxation. In Dillon v. United States, 792 F.2d 849 (9th Cir. 1986), cert. denied, 480 U.S. 930 (1987), the court followed the approach used in Critzer and held that smokeshop income was not generated principally from the use of reservation land resources and the income is more akin to reinvestment income rather than income derived directly from the land. See also Hale v. United States, 579 F.Supp. 646 (E.D. Wash. 1984).

In Anderson, the court held that a noncompetent Indian's income allocable to cattle grazing under a tribal license, on land held in trust by the United States for other Indians was taxable. Anderson was a noncompetent Sioux member of the Fort Peck Tribes and a cattle rancher. His headquarters was on his allotted land, but he grazed cattle, under a tribal license, on a land-use program unit consisting of parcels held in trust by the United States for several noncompetent Indians. The court held that Anderson's income, if any, allocable to his own allotted land is tax-free, but the income allocated to the grazing unit is taxable. See also Holt v. Commissioner, 44 T.C. 686 (1965), aff'd, 364 F.2d 38 (8th Cir. 1966), cert. denied, 386 U.S. 931 (1967).

In this case, the taxpayers are allottees of the [redacted] Indian Reservation of [redacted]. The income they receive from the oil and gas mining lease with [redacted] will not be subject to tax if their allotted land is held in trust by the United States and Congress has enacted legislation which exempts the allotted land from all taxes until the fee interest is conveyed to them. See Clark v. United

States, 587 F.2d 465 (10th Cir. 1978); United States v. Daney, 370 F.2d 791 (10th Cir. 1966). Based upon the following analysis, we are of the opinion the taxpayers' allotted land is held in trust by the United States and the income they receive from [redacted] pursuant to the oil and gas mining lease is exempt from taxation.

The first congressional enactment concerning the allotment of the [redacted] lands occurred in 1880. In the Act of June 15, 1880, ch. 223, 21 Stat. 199 ("1880 Act"), Congress provided:

> That the Government of the United States cause the lands so set apart to be properly surveyed and to be divided among the said Indians in severalty in the proportion hereinbefore mentioned, and to issue patents in fee simple to them respectively therefor, so soon as the necessary laws are passed by Congress. The title to be acquired by the Indians shall not be subject to alienation, lease, or incumbrance, either by voluntary conveyance of the grantee or by the judgment, order, or decree of any court, or subject to taxation of any character, but shall be and remain inalienable and not subject to taxation for the period of twenty-five years, and until such time thereafter as the President of the United States may see fit to remove the restriction, which shall be incorporated in the patents when issued, and any contract made prior to the removal of such restriction shall be void.

In addition, in section 4 of the 1880 Act, Congress further spoke to the taxability of the allotted parcels:

> That upon the completion of said allotments and the patenting of the lands to said allottees, each and every of the said Indians shall be subject to the provisions of section nineteen hundred and seventy-seven of the Revised Statutes and to the laws, both civil and criminal, of the State or Territory in which they may reside, with the right to sue and be sued in the courts thereof: Provided, That their lands and personal property shall not be subject to taxation or execution upon the judgment, order, or decree of any court obtained on any cause of action which may arise during the period named in the above recited agreement [the twenty-five year trust period].

Thus, under the 1880 Act, there are several prerequisites to the taxation of allotted lands. First, Congress must enact "the necessary laws" to accomplish the allotment, second, the twenty-five year trust period must expire, and third, the President must act to remove the restriction on alienation and taxation.

The first prerequisite occurred in 1895. By the Act of February 20, 1895, ch. 113, 28 Stat. 677 ("1895 Act"), Congress passed the necessary laws to begin the allotment process. The 1895 Act also required the President to issue a proclamation within six months of its passage "declaring the lands embraced within the present reservation of said Indians except such portions of the preceding sections of the Act, open to occupancy" for homestead settlement. Section 4 of 1895 Act. President McKinley issued such a proclamation on April 13, 1899, however, the proclamation was not within the six-month period as specified in the 1895 Act. Proclamation No. 2, 31 Stat. 1947 (1899).

As to the two remaining prerequisites for taxation under the 1880 Act, expiration of the twenty-five year trust period and a presidential order lifting the restriction on alienation, [redacted]. The IRA extended the periods of trust placed upon Indian lands and any restriction on alienation thereof "until otherwise directed by Congress." 25 U.S.C. § 462. Since the trust period did not expire before 1934 and the President did not act to lift the restriction on alienability and taxability before that date, lands allotted to individual Indians under the 1880 and 1895 Acts are still subject to those restrictions.[2] Consequently, the income from the oil and gas mining lease which is attributable to allotted lands is exempt from federal taxation.

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[2] Further evidence showing that the restrictions still exist is the fact that the Bureau of Indian Affairs, a division of the Department of Interior, had to approve the oil and gas mining lease. The lease provides that all wells, producing operations, improvements, machinery, and fixtures thereon and connected therewith and all books of accounts of the lessee shall be open at all times for the inspection of any duly authorized representative of the Secretary of the Interior.

Based upon the foregoing discussion, the 1880 and 1895 Acts exempt allotted lands from all taxes until the fee interest is conveyed to the allottee. Since the taxpayers have not received a fee interest in their allotted land and the income they receive from the oil and gas mining lease is derived directly from the land, the income is exempt from taxation.

If you have any questions or need further assistance, please contact James R. Robb, the attorney assigned to this case, at (303) 844-2214, ext. 253.

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By: _____
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